

Responding to Today's Lifestyles

At Kroger today, responding to the lifestyle needs of shoppers is the Company's top merchandising priority. One example is the fresh salad bar (cover), which appeals directly to consumers who want both nutrition and convenience. For other examples, please turn to the section on Lifestyle Merchandising, which begins on Page 8.



Supermarkets

The Kroger Co. operates 1,317 supermarkets in the United States, many of them large-scale food and drug combination stores. The stores operate under a variety of names, including *Kroger*, *King*

Soopers, *City Markets*, *Fry's*, *Dillon Food Stores*, *Circle Soopers*, *Gerbes*, *M&M Markets*, *Florida Choice* and *Welcome*.



Convenience Stores

The Company operates 889 convenience stores. They are: *Turkey Hill Minit Markets* in Pennsylvania; *Tom Thumb* in Florida and Alabama; *Time Saver* in Louisiana; *Kwik Shop* in Kansas,

Iowa and Nebraska; *Quick Stop* in California; *Loaf'N Jug* in Colorado and New Mexico and *Mini Mart* in Wyoming, Montana, Colorado, Nebraska and the Dakotas.



Food Processing

The Kroger Co. supports its retail stores with more than 4,000 private label products manufactured in 38 processing plants, including 11 bakeries and 15 dairies.

In addition, Kroger products are manufactured for outside customers, including other retailers, the federal government and national brand food processors.



Membership Warehouses

Through its *Price Savers Wholesale Warehouse, Inc.*, subsidiary, the Company operates 12 membership warehouses, primarily for small business clients. A wide variety of food and non-

food products are available at discount prices in *Price Savers'* large 100,000 square foot facilities, which are located in the Far West, Alaska, southern California and the Midwest.

FINANCIAL HIGHLIGHTS

| | 1987 (52 weeks) | 1986 (53 weeks) | 1985 (52 weeks) |
|--|------------------------------------|------------------------------|--------------------|
| Sales | | | |
| From continuing operations | \$ 17.7 billion | \$ 17.1 billion | \$ 16.0 billion |
| Increase over prior year | 3.1% | 7.2% | 6.0% |
| Earnings | | | |
| From continuing operations | \$183.3 million^a | \$ 55.8 million ^b | \$159.6 million |
| Per common share* | \$2.20 | \$0.60 | \$1.81 |
| Return on average equity from continuing operations | 16.0% | 4.8% | 13.7% |
| Dividends per common share* | \$1.05 | \$1.025 | \$1.00 |
| Capital Expenditures | \$415.8 million | \$474.6 million | \$362.4 million |
| Real Estate data | | | |
| Food stores | | | |
| Opened and acquired | 100 | 60 | 62 |
| Total at year-end | 1,317 | 1,272 | 1,343 |
| Convenience stores | | | |
| Opened and acquired | 160 | 104 | 220 |
| Total at year-end | 889 | 735 | 643 |

* Adjusted to reflect 2-for-1 stock split in 1986.

^a Includes an after-tax credit of \$3.8 million, or five cents a share, for over-estimation of restructuring costs, and excludes a one-time credit of \$63.3 million, or 79 cents a share, for a change in accounting for deferred taxes.

^b Includes special charge of \$82.3 million, or 95 cents a share, after-tax, for corporate restructuring and a \$10 million after-tax charge for the establishment of the corporate charitable foundation.

TO OUR FELLOW SHAREOWNERS:

The Kroger Co. is always evolving as we respond to changing consumer needs and our competitive environment. At no time was this more evident than 1987.

To better meet the shopping expectations of customers, Kroger became increasingly oriented to a *local* merchandising approach in 1987. We also improved our ability to make rapid adjustments in

strategies on a market by market—even a store by store—basis in order to deal with changing competitive conditions.

Our corporate restructuring, implemented in 1986 and 1987, has helped the organization become more responsive to change. During the year, Kroger strengthened its asset performance, reduced operating costs and placed added emphasis on merchandising diversity—all in response to the constantly changing patterns of our business.

Our 1987 financial performance, meanwhile, established new Company records.

Kroger sales rose to \$17.7 billion, and earnings from continuing operations increased to a record \$183.3 million, or \$2.20 per common share. Return on equity from continuing operations was 16.0%—encouraging, but still below what

we had hoped to achieve.

Several events affected these results: a costly work stoppage in Denver, high start-up costs for our *Welcome* super-warehouse venture in South Carolina and development costs related to expansion in Florida.

But a key factor was an industry-wide slowdown in consumer spending, especially in the last two quarters of 1987. The result was an increase in price-oriented retailing, which adversely affected Kroger's profit margins and sales momentum.

Managing Change

Kroger is constantly developing new responses to strengthen our competitive position and satisfy our customers' expectations.

For example, the latest versions of Kroger stores in Cincinnati, Lexington and Ft. Worth are models of the lifestyle-oriented merchandising and operational strategies we are pursuing. Yet each contains key



Joseph A. Pichler
President and
Chief Operating Officer

Lyle Everingham
Chairman and
Chief Executive Officer

differences in format that reflect the wide variety of our shoppers' tastes and preferences. As a result, there is broad diversity in advertising, store formats and merchandising variety throughout the organization.

Our convenience stores also are changing and broadening their appeal. They are offering in-store fast food service and video rentals as an extension of their market among convenience-minded shoppers. Our *Price Savers* membership warehouses add to our diversity by serving yet another specific customer niche: small business.

Kroger's recent negotiated settlements with unionized labor better meet our needs in operating today's large supermarkets in an increasingly non-union environment. They contain flexible work schedules, creative forms of bonus compensation and more work rule latitude in the fast-expanding

service areas like delicatessens, salad bars and floral shops.

Kroger also is breaking away from the traditional way we perform basic functions such as distribution and procurement.

Since our cost of purchasing the products we sell represents about three-fourths of Kroger's total sales, we are actively exploring a number of opportunities to significantly reduce that cost.

We also are more flexible in the way merchandise is distributed to our stores. In our floral business, for instance, we can better manage costs and quality by involving ourselves at every step in the distribution process. The converse applies in other situations: in Florida, Kroger maintains a substantial retail presence with no company assets invested in distribution.

The 1988 Challenge

Following several years of sustained growth, the economy may slacken its pace in 1988.

In such an environment, there will be increasing pressure on sales and profits. In addition, we are confronted with a shrinking labor pool and increased training needs at just the time when our in-store staffing requirements are increasing.

We must deal with these challenges in the near term without losing sight of our longer-range goals of improved return on equity and market-by-market sales growth.

We must also continue to build on our inherent advantages in such areas as procurement, while broadening decision-making and merchandising diversity that is responsive to local market conditions.

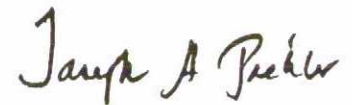
Kroger has the basic elements in place to be successful: modern facilities, a broad geographic base and plenty of merchandising talent. These elements, combined with a more flexible organization,

make us confident that 1988 will be a rewarding year for our shareowners, our customers and our employees.



Lyle Everingham

Chairman and
Chief Executive Officer



Joseph A. Pichler

President and
Chief Operating Officer

February 15, 1988

1987 Financial Highlights

The Kroger Co. is made up of four related business segments: supermarkets, manufacturing operations, convenience stores, and membership warehouses. These various businesses operate in 32 states and employ a total of 170,000 people.

Combined sales of these units totaled \$17.7 billion in 1987, a 5.2% increase over 1986 after adjusting for an extra week in the previous year. Earnings totaled \$183.3 million, or \$2.20 a share before a one-time accounting change for deferred taxes. With the change included, earnings were \$246.6 million, or \$2.99 a share.

Based on continuing

operations, Kroger's return on common equity (ROE) increased to 16.0%.

Business Segments

Supermarkets—Kroger's supermarkets, which account for about 91% of total Company sales, produced sales of \$16 billion in 1987.

The retailing environment for the year was characterized by intensified competition and softening sales, especially in the last two quarters. In response, Kroger's business strategy consisted of active merchandising programs directed towards the convenience-minded shopper, combined with increased emphasis on reductions of product and operating costs.

Corporate overhead was trimmed by approximately 20%, and important new labor agreements were signed in Michigan, West Virginia, Texas, Atlanta, Nashville and Denver. These

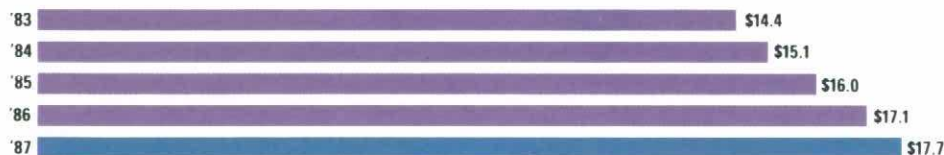
contracts provide Kroger with more operating and competitive flexibility.

Acquisition activity was limited but significant. Kroger's *Florida Choice* division purchased 21 A&P Family Mart stores in January. Our new super-warehouse venture, *Welcome*, opened its first facility in Greenville, SC, and also acquired four large-scale stores in Jacksonville, FL and Mobile, AL. Kroger also purchased nine Safeway stores in Dallas.

All told, the Company operated 1,317 supermarkets at year-end, a net gain of 45 stores over 1986. Total square footage reached 48.6 million square feet, up 9.5% and reflective of the Company's commitment to the larger size combination food and drug store.

New stores averaged 52,755 square feet. In many instances, they replaced smaller, older facilities. Kroger also expanded 10 existing stores and remodeled 67 others.

SALES (Billions)



Among the new store openings, several were prototypes of formats that will serve as models for our store facilities well into the 1990s. These model stores, in Cincinnati, Ft. Worth and Lexington, KY, contain unique combinations and presentations of our specialty departments. Our experience operating them will help us select the appropriate mix of service departments for the next generation of stores.

Convenience Stores—Kroger operates the fourth largest convenience store group in the United States, as measured by sales and earnings. Kroger's 889 convenience stores generated sales of \$600 million, including sales from the 115-store *Mini Mart* chain based in Casper, WY, acquired in May.

Earnings for the convenience store group also improved. However, profit growth was affected by lower gasoline

margins during much of the year and depressed economic conditions in some parts of the country, especially in the energy and tourist dependent Gulf Coast area.

The convenience store market is rapidly changing. There is significant opportunity for expansion because convenience stores are natural "fill in" locations amid the larger-scale combination stores and supermarkets. Yet competition for the convenience segment is growing as the lines distinguishing grocery stores, convenience stores and the traditional gasoline and fast food outlets continue to blur.

As more competitors enter the field, profit margins are under constant pressure. In addition, declining consumption of key product categories, such as tobacco and beer, plus erratic gasoline prices, also are affecting sales growth.

Responding to consumer needs, Kroger's convenience stores remodeled facilities to accommodate changing product selection.

A number of convenience stores have added self-serve fast food items, such as pizza, along with new services like video rentals.

EARNINGS FROM CONTINUING OPERATIONS (Millions)

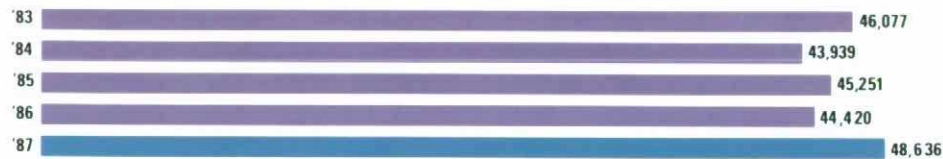


Food Processing—Sales in the Kroger Manufacturing division declined slightly in 1987 from the previous year.

The downturn largely reflects the impact of the changing base of Kroger supermarkets, which are the division's primary customers. For instance, the full effect of the Company's withdrawal from the St. Louis market in late 1986 was felt throughout 1987, and was only partially offset by new store openings.

Important progress was made in the development of non-Kroger sales during the year. These “outside” sales amounted to approximately 20% of the total.

SUPERMARKET SQUARE FOOTAGE (Thousands)



The division also introduced a number of new package designs and launched its first gourmet line of products, *International Bazaar*.

Membership Warehouses—

The warehouse club industry is still in its infancy, but shows impressive growth. Kroger is involved in this expanding niche through its *Price Savers* Wholesale Warehouse unit, which has headquarters in Salt Lake City.

In 1987, *Price Savers* doubled its size by adding six new warehouses, for a total of 12 at year-end, and was profitable for the year. Sales in the warehouses opened prior to 1987 increased more than 25%. Expansion was concentrated in southern California. A unit also opened in Cincinnati, representing *Price Savers'* first location in a traditional Kroger market.

Other Developments

Late in 1986, the Company announced plans to repurchase up to 10 million shares of its outstanding common stock, using proceeds from the sale of assets arising from the corporate restructuring.

The repurchase was substantially completed in 1987, leaving Kroger at year-end with approximately 78.6 million shares outstanding, a 6.5% decrease from 1986.

Early in 1988, the Company announced its intention to sell

\$100 million of medium-term notes with maturities ranging from nine months to 25 years. Kroger also sold \$125 million of Auction Preferred shares. Proceeds will be used for general corporate purposes and to repay short-term borrowings.

Storing Plans

Kroger is aggressively refurbishing its asset base in retail facilities, primarily in the large-scale combination store format.

These stores are costly to build, so location decisions involve detailed research and financial analysis before construction.

Capital spending for each of the next three years is expected to average about \$350 million. This will enable Kroger to build about 60 new stores, expand 20 others and remodel an additional 60 stores *each* year.

In Kroger's convenience store

group, growth will continue to come primarily from acquisitions. However, among the seven convenience store companies within the group, approximately 60 new stores are planned for 1988.

Price Savers anticipates opening another six warehouses, which will bring its total to 18.

Corporate Responsibility

The civic and charitable activities of the Company supported a variety of national, regional and local community projects.

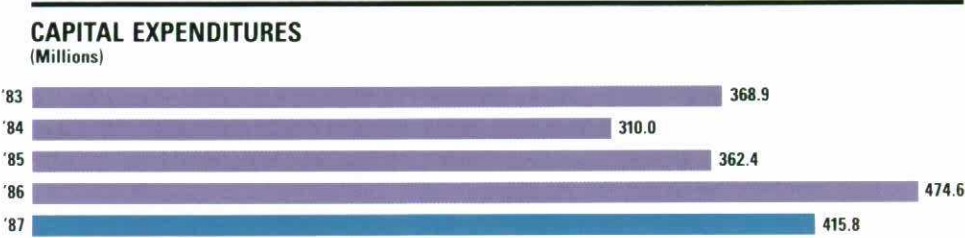
Among these efforts was the Company-wide program to combat domestic hunger. Through the volunteer efforts of store employees and often times with the active participation of Kroger shoppers, product donations totaling approximately one million pounds were donated to local food banks. The Company also contributed \$100,000 to Second Harvest, the

national food bank organization, for the third straight year.

At the local and store level, Kroger employees led or were active participants in a number of civic and charitable causes. In Lexington, KY, store employees joined in a variety of community projects and gained recognition as winners of the Company's B.H. Kroger Award for Community Service. In Detroit, Kroger meat department employee Jerry Franchy was similarly honored for a lifetime of volunteer service.

Also in 1987, The Kroger Company Foundation began operation, endowed with a 1986 corporate contribution of \$20 million.

In its first year, the Foundation made more than 600 grants totaling \$2.1 million. The majority of these went for programs supported by United Way, as well as for programs



in education and the arts.

The various operating units of the Company made cash and product donations in their areas to hundreds of programs throughout the year. This activity alone generated several million dollars for local charities.

The Kroger delicatessen reflects today's—and tomorrow's—lifestyles.

Modern consumers wish to spend less time cooking, yet increasingly, they prefer to eat at home. As a result, the in-store deli has become a convenient source of high quality meals for time-conscious Americans.

Reflecting this trend, the variety of products offered by Kroger delis has expanded dramatically.

Gourmet entrees and salads put to rest the old-fashioned notion of a super-market delicatessen as being nothing more than a lunch meat case. Some increasingly

typical fare might include chef-prepared roast leg of lamb with asparagus spears and cheddar cheese stuffed potatoes, or crepes a la Reine, chicken cordon bleu, ricotta cheese stuffed shells, pork chops stuffed with apples and plums, B.B.Q.



baby back ribs or chicken and grapes gourmet salad.

The key, however, is that these selections are available amid the convenience of the full-service combination food and drug store. Kroger combo stores give shoppers the opportunity to visit the floral shop, have a prescription filled or complete other daily shopping errands—and pick up an already prepared evening meal—all in the same trip.

For today's no-time-to-waste lifestyles, that kind of convenience gives new dimension to meal planning.



Once the accepted beverage of the select few, wine has become increasingly commonplace in the lifestyles of millions of American consumers—especially at mealtime.

Parlaying that interest into an expanding wine selection in Kroger supermarkets, the Company has increased sales and helped re-shape the image of wine.

Nowhere is this more apparent than in the category of premium California wines.

Kroger has joined with the industry to promote the product as a natural complement to the

table-ready entrees available in the service meat and deli counters of the modern Kroger combination store.

At the same time, Kroger is enhancing the accessibility of wine. Highly trained Kroger wine specialists help take the mystery out of wine selection by

offering friendly, no-nonsense advice to shoppers. Our specialists are adept at suggesting the right wine for the customer's entree. A toll-free phone service is being tested to help customers with wine recommendations and meal recipes.

That's a long way from the traditional method in which wine has been merchandised in supermarkets over the years. But in response to the lifestyle choices of today's consumers, it's an approach that is vintage Kroger.





Modern shoppers are returning to the traditions of the past, including the desire for quality baked products that are fresh, tasty and readily available.

Kroger's in-store bakeries are responding to this trend with a personal touch.

Cakes, for example. Today's shopper can select customized birthday cakes, or fancy desserts and even gourmet cakes—all designed to meet each customer's personal requirements, and always satisfaction guaranteed.

It's the kind of service shoppers expect. In-store bakeries are freeing the lifestyles of the family cook. Less time in the kitchen means more quality time to spend with the family and more free time to pursue personal interests outside the home—without



neglecting the traditional.

The in-store bakeries operated by Kroger fulfill that need. With state-of-the-art preparation and highly trained service personnel, the bakery in a Kroger supermarket provides the product—and the nostalgia—that make up one of America's most lasting memories.



Prompted by changing tastes, increasing variety and concerns over diet and health, fresh seafood is enjoying rapid growth as a staple of the American diet.

Kroger is the leading seafood merchandiser because it has literally created the market for a product that once was limited in distribution.

In a typical Kroger Seafood Shop, more than 50 varieties of fresh fish are available, including such delectables as Alaskan King Salmon ...Mahi Mahi from Ecuador...Swordfish from Thailand.

These products are available because Kroger's seafood buyers know where to find the best quality catch at the lowest prices. Our distribution system ensures that from date of harvest anywhere in the world, Kroger fresh seafood reaches supermarket display cases in a



matter of days. Finally, Kroger seafood is marketed aggressively, with an emphasis on variety, taste and availability.

The entire business could not have been more perfectly timed. In an era when what one eats defines personality and lifestyle, fresh seafood is a product with a natural appeal.



CORPORATE OFFICERS

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Dillon Companies, Inc.

Richard W. Dillon
Vice Chairman of the Board
Dillon Companies, Inc.

Walter R. Dryden
Senior Vice President

Donald F. Dufek
Group Vice President

Lyle Everingham
Chairman of the Board and
Chief Executive Officer

Jack G. Hudson
Group Vice President

Lorrence T. Kellar
Group Vice President

Richard M. Koster
Executive Vice President

George A. Leonard
Vice President and
General Counsel

Thomas E. Murphy
Group Vice President

Joseph A. Pichler
President and
Chief Operating Officer

William J. Sinkula
Group Vice President and Secretary

Lawrence M. Turner
Vice President and Treasurer

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Chairman of the Board
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Chairman of the Board and
Chief Executive Officer
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Chief Executive Officer
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Dillon Companies, Inc.

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Chief Executive Officer
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Indiana University

Otis M. Smith^{1,3}
Of Counsel
Lewis, White & Clay

Board Committees:
(as of 1/3/88)

- 1 Audit
- 2 Compensation
- 3 Corporate Responsibility
- 4 Executive
- 5 Financial Policy
- 6 Nominating

KROGER STOCK OWNERSHIP PLANS

Kroger has a variety of ways individuals can own stock in the Company. Some of these plans are for employees, others for general investors.

The following is a description of each plan and how the administrators can be reached.

GENERAL SHAREOWNERS: If you possess a stock certificate for The Kroger Co. and have questions about dividends, changes of address, 1099's, etc., contact:

Morgan Shareholder Services Trust Co.
Transfer Agent and Registrar
P.O. Box 3981, Church Street Station
New York, New York 10008-3981
1-212-587-6515

KROGER EMPLOYEES: The Company has three plans in which you can accumulate shares of Kroger stock. They are:

(A) **THE KROGER STOCK EXCHANGE**—a voluntary monthly payroll deduction plan. If you have any questions or wish to sell stock you have purchased through this plan, contact:

The First National Bank of Cincinnati
P.O. Box 1118
Cincinnati, Ohio 45201
In Cincinnati, call: 632-4397
In Ohio: 1-800-346-7500
Outside Ohio 1-800-354-0400

(B) **ESOP**—Kroger common stock held in an ESOP trust for individual employees who have met the eligibility requirements to become participants. If you have questions concerning the ESOP, contact your local personnel manager.

(C) **401(k) PLAN**—This plan enables eligible employees to defer compensation on a pre-tax basis. Funds deferred can be placed in one or more investment accounts, one of which consists of Kroger common stock. The Company provides a match for these investments and a profit match on all investment funds based on the total increase in Company pre-tax profit. Interested employees should contact their local personnel manager.

Shareowner Information

Form 10-K—A copy of the Company's 1987 report to the Securities and Exchange Commission, Form 10-K, is available on request by writing: Lawrence M. Turner, Vice President and Treasurer, The Kroger Co., 1014 Vine St., Cincinnati, Ohio 45202-1119

Annual Meeting—The annual meeting of shareowners will be held at the Grand Ballroom of the Westin Hotel at Fountain Square, Cincinnati, Ohio, on May 19, 1988, at 10 a.m.

Common Stock—The main trading market for The Kroger Co.'s common stock is the New York Stock Exchange, where it is listed under the symbol KR.

Independent Certified Public Accountants—Coopers & Lybrand, 1500 Atrium One, 201 East Fourth St., Cincinnati, Ohio 45202

Shareowners—At the end of 1987, a total of 65,608 shareowners of record owned 78,581,249 shares of Kroger's common stock.

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